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Supreme Court of the United States

October Term, 1952

Roy H. Fitzgerald,

Petitioner,

vs.

The Commissioner of Internal Revenue,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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Supreme Court of the United States

October Term, 1946.

No. ————.

ROY G. FITZGERALD,

Petitioner,

vs.

THE COMMISSIONER OF INTERNAL REVENUE.

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

The Petitioner Roy G. Fitzgerald prays that a writ of certiorari issue to review the judgment entered May 29th, 1946, in the United States Circuit Court of Appeals for the Sixth Circuit in the above entitled cause.

STATEMENT OF MATTER INVOLVED

The petitioner, a taxpayer of Dayton, Ohio, filed in the Tax Court of the United States, April 8, 1944, his appeal from a determination by the Commissioner of Internal

Revenue of a deficiency in his Income Tax Return for the calendar year 1941. He complained that the Commissioner had erroneously disallowed a deduction representing a loss by bad debts, to-wit: amount loaned to Thomas L. Hume, Jr. of Washington, D. C., during the years 1933 to 1936, evidenced by demand notes and a book account (*Record, pp. 3-10*). The Tax Court by its Memorandum Findings of Fact, June 22, 1945, (*Record, pp. 8-10*) found said debt to be a bona fide debt; that no repayment had been made; the debtors (husband and wife) owned their equity in their home at Washington, encumbered by mortgages; the property was worth enough above the liens to equal petitioner's loan; that the petitioner asked a Washington attorney in 1941 to collect the debt or advise him as to collectibility; the attorney had advised against filing suit as a judgment would not be collectible. The court further found "no part of the indebtedness became worthless in the year 1941" (*Record, pp. 8-10*). The Tax Court's Opinion held that the only property the debtors possessed from which collection could have been made was the equity in their home, but this being in excess of the debt to petitioner plus other debts of the husband, the indebtedness "did not become worthless to any extent in 1941 and in fact was not uncollectible in that year." It further held that *Section 23 (k)* of the *Internal Revenue Code* provides for deduction of "debts which become worthless within the taxable year;" that this language was substituted by *Section 124 (a)* of the *Revenue Act of 1942* for the language of former acts permitting deduction of "debts ascertained to be worthless and charged off within the taxable year;" that this amendment is made retroactive by *Section 124 (d)* of said act of 1942 to taxable years beginning after December 31, 1938; that there was no showing that the condition with respect to possibility of

collection changed in any way between 1938, 1939, 1940, or 1941; and that in 1941 the debt was "in all probability collectible in full if petitioner had been willing to take legal steps to enforce collection by sale of the Hume home" (*Record, pp. 10-12*). Decision was entered for respondent June 23, 1945. Petitioner filed his motion for rehearing July 7, 1945, giving as one reason, that the decision disregarded the three-year limitation of *Section 201, Title 12, District of Columbia Code* (31 Stat. p. 1389, ch. 854 Sec. 1265), which barred legal action in 1941. His motion was denied without comment July 10, 1945. He filed his Petition for Review in the United States Circuit Court of Appeals for the Sixth Circuit July 30, 1945 (*Record, pp. 15-18*) assigning as errors, that the Tax Court had erred (1) in finding and holding that no part of the indebtedness became worthless in 1941; (2) in holding that the amendment of *Section 23 (k) Internal Revenue Code* by *Section 124 (a) Revenue Act of 1942* is retroactive as to petitioner's 1941 Income Tax Return. Said Circuit Court of Appeals affirmed the Tax Court's decision, April 10, 1946, "upon the grounds and for the reasons set forth in its Memorandum Findings and Opinion entered June 22, 1945" (*Record, p.*). Petitioner on April 22, 1946, filed his Petition for Rehearing, giving as reasons: (1) The court's failure to notice or comment on the three-year limitation of the District of Columbia Code, which rendered the debt worthless according to Internal Revenue Regulations (74) (*Code of Federal Regulation, Title 26, Ch. 1, Pt. 3; 323 (k), pp. 119, 120*); (2) Its failure to notice or comment on his contention that the Revenue Act of 1942 does not require by its letter or purpose to be applied retroactively to his 1941 Tax Return; that such application denies due process, and is *ex post facto* legislation, in vio-

lation of the Constitution Amendment V and Article I Section 9. Said Petition for Rehearing was denied without comment, May 29, 1946.

JURISDICTIONAL STATEMENT

The jurisdictional basis of this plea is *28 USCA Section 347* (Judicial Code Section 240 as amended by Act of February 13, 1925, c. 229, sec. 1, 43 Stat. 938).

The federal statutes whose validity is involved are: (1) *26 USCA Section 23 (k) (1)* as amended by Revenue Act of 1939 (Act of May 28, 1938, c. 289, 52 Stat. 447-584); (2) as amended retroactively by Revenue Act of 1942, Sec. 124 (a) and (d), and Sec. 136 (b) (Act of October 21, 1942, c. 619, 56 Stat. 798); and (3) District of Columbia Code XII-201 (31 Stat. 1389, ch. 854 Sec. 1265). Pertinent sections are set forth more at length in the Appendix hereto attached.

QUESTIONS PRESENTED

1. Whether a taxpayer may properly deduct from his income tax return for 1941 as "bad debt" under Section 23 (k) (1) Internal Revenue Code, a claim for loans advanced during 1933-1936 to debtors (husband and wife) upon demand notes and book account (R. 8-12), no repayment having been made, the only property possessed by debtors from which collection could be made being an equity in their doubly mortgaged home, in Washington, D. C., said equity being in excess of taxpayer's claim; but taxpayer's Washington attorney on being requested to look into the matter and collect or advise as to possibility, advised in 1941 against suit as judgment would be uncollectible (R. 10); and suit was barred by 3-year limitation

of District of Columbia Civil Code Title 12-201; and Treasury Regulations 103 promulgated under Internal Revenue Code: Sec. 19.23 (k)-1. (b) allowed deductions "where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment."

2. Whether Section 124(a) Revenue Act of 1942 is made retroactive by Section 124(d) of said Act, so as to limit taxpayer in his income tax return for 1941 to deduction only of "debts worthless within the taxable year" instead of "debts ascertained to be worthless and charged off within the taxable year," where the debts in question were owing unchanged from the years 1933-1936; the said Section 124(a) being expressly made retroactive only to taxable years beginning after December 31, 1938.

3. Whether the Revenue Act of 1942 retroactively governing by its Section 124 (a) and (d) a deduction under Section 23 (k) (1) Internal Revenue Code in an income tax return for 1941 of debts existing unchanged from the years 1933-1936, denies due process in violation of the Constitution Amendment Five.

4. Whether said retroactive amendment of Section 23 (k) (1) Internal Revenue Code is *ex post facto* legislation, in view of the fact that said Revenue Act of 1942 in its Section 136(b) creates a new penalty (Section 145(c) Internal Revenue Code) for anyone "who willfully makes and subscribes a return which he does not believe to be true or correct as to every material matter."

REASONS FOR ALLOWANCE OF THE WRIT

1. The Circuit Court of Appeals in holding a debt owing since 1936 "not worthless" in 1941 and not deductible

under Section 23 (k) (1) Internal Revenue Code but "in all probability collectible in full if petitioner had been willing to take legal steps to enforce his collection by sale of the Hume home," (R. 11-12), has rendered a decision upon an important question of federal law of general applicability, which has not yet been, but should be, settled by this Court, inasmuch as such legal action was barred by three-year limitation of District of Columbia Civil Code, legal advice was asked and given against it as useless, and Treasury Regulation 103 seems to justify deduction under such circumstances. Much confusion is likely to occur unless this is clarified.

2. In holding Section 23 (k) (1) Internal Revenue Code to have been amended retroactively by Section 124 (a) and (d) Revenue Act of 1942 so as to govern an income tax return for 1941 in deduction of a claim for alleged bad debts created in 1933-1936 existing unchanged between 1938 and 1941, said circuit court has rendered a decision upon another important question of federal law which has not yet been settled by this Court; and upon which there is dissension among the judges of the United States Circuit Court of Appeals of the 2d Circuit in the parallel case *Metzler* v. *Commissioner*, rendered April 15, 1946, reported in '46 (CCH)-4 Court Decision #9236, wherein the majority (Phillips and Swan, JJ.) on petition to review a decision of the Tax Court affirmed the Tax Court in disallowing a deduction claimed in a tax return for 1941 for uncollectible debts incurred in 1935, because same "did not become worthless in 1941," as required by the retroactive amendment of 1942; but Chief Justice L. Hand in a vigorous dissenting opinion maintained that as the 1942 amendment was retroactive only to December 31, 1938, "deduction of debts becoming worthless before then was to be determined under the old law." * * * (and) "be

deducted in the year in which the creditor 'ascertained' that they became worthless." See Appendix for full opinion.

3. In holding the Revenue Act of 1942 retroactively amendatory of Section 23 (k) (1) Internal Revenue Code as to deduction for debts incurred in 1933-1936 claimed in an income tax return for 1941, said circuit court has rendered a decision probably in violation of "due process" guaranteed by Amendment Five of the Constitution; and also, because said Act creates a new penalty (Section 136 (b) of the Act) by inserting subsection (c) to Section 145 Internal Revenue Code, probably in violation of the *ex post facto* inhibition of Article I Section 9 of the Constitution. Neither of these important questions has yet been settled by this Court, and they are likely to cause confusion, grave injustice, and hardship unless clarified.

ROY G. FITZGERALD
Petitioner.
JOSEPH W. SHARTS
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION

OPINIONS OF LOWER COURTS

The Opinion of the Tax Court of the United States is reported in 4 (*CCH*) *Tax Court Decisions #14,640 (M)*. It was written by Judge Leech, was filed June 22, 1945, and appears on pages 10-12 of the record.

The Opinion of the Circuit Court of Appeals (Hicks, Simons, and Miller, Judges) is reported in 4 (*CCH*) *Court Decisions #9249*. It was written by Hicks, C. J., was filed April 10, 1946, and appears on page — of the record.

JURISDICTIONAL STATEMENT

The jurisdictional statement is embodied in the Petition and is not repeated here.

STATEMENT OF THE CASE

This is an application for a writ of certiorari to review a judgment of the United States Circuit Court of Appeals for the Sixth Circuit, which affirmed a decision of the Tax Court of the United States. The material facts and questions involved are set forth in the foregoing petition.

The statutes involved are set forth more at length in the Appendix hereto attached. They are:

District of Columbia Code Title 12 — 201 and — 305.

Internal Revenue Code Section 23 (k) (1) and Section 145(c).

Revenue Act of 1942 Section 124 (a) and (d); and Section 136 (b); (Act of October 21, 1942; c. 619, 56 Stat. 798

ARGUMENT

First Point

Internal Revenue Regulation (Code of Federal Regulations, Title 26, Ch. 1; 3:23 (k) pp. 119 and 120; 26 CFR 1, 3:23(k)-1) in force in 1941 provides:

> "(b) * * * Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction."

The ruling of the Circuit Court of Appeals seems to be in sharp conflict with the above regulation. Although the bar of limitation of the District of Columbia Code XII — 201 rendering legal action in all probability futile was repeatedly called to the attention of both the Tax Court and the Circuit Court of Appeals by brief and in argument, neither court has noticed it in rendering judgment. Said judgment seems also to be in conflict with and contrary to a judgment by the same circuit court rendered in 1932 (Dennison, Moorman, and Hickenlooper, Judges) in *Duffin* v. *Lucas*, 55 Fed. 2d., 786, 795, Syl. 22, 23, certiorari denied, 287 US 64, 77 L. Ed. 531, 53 SCR 14, in which the court held the burden was on taxpayer to show why he had not charged off the debt as worthless in 1918 when same became uncollectible from the running of the statutory limitation.

Second Point

The debts were all created in 1933 to 1936 and nothing ever paid on them (Record, pp. 8, 9). The lower court found "absolutely no showing that the condition with respect to possibility of collection changed in any way between 1938, 1939, 1940 or 1941" (Record, p. 11). The Revenue Act of 1942 is retroactive (if at all) only to December 31, 1938, with regard to deductions for bad debts under Internal Revenue Code 23 (k) (1). So your petitioner's claim antedates the retroactive scope of the amendment. Our contention that his right of deduction thereon should be governed by the former law and not the amended law, is supported by the strong dissenting Opinion of Chief Justice L. Hand of the Second Circuit in the parallel case of *Meltzer et al.* v. *Commissioner,* rendered April 15, 1946, 4 (CCH) Court Decisions #9236, majority Opinion by Judge Phillips.

Third Point

Said decision, applying the law for deductions (Sec. (23 (k) (1) Internal Revenue Code) as amended in 1942, to claims existing as far back as 1933-36, deprives taxpayer of all right of deduction, and would seem to be a denial of his constitutional right of due process as defined by numerous decisions of this Court refusing to uphold retroactive tax laws that lack "the clearest mandate" (*Claridge Apartments Co.* v. *Commissioner,* 323 U. S. 141, 164), or are harsh, arbitrary, and oppressive (*Hassett* v. *Welch,* 303 U. S. 303, *Welch* v. *Henry,* 305 U. S. 134, 147, and other cases).

Fourth Point

The Revenue Act of 1942 adds this new penalty to the Internal Revenue Code:

> "*Section 136(b).* Section 145 is amended by inserting after subsection (b) the following new subsection: '(c). — Any individual who willfully makes and subscribes a return which he does not believe to be true or correct as to every material matter, shall be guilty of a felony, and upon conviction thereof, shall be subjected to the penalties prescribed for perjury in section 125 of the Criminal Code.' "

The Circuit Court's decision that the Revenue Act of 1942 retroactively governs a taxpayer in his income tax return as to deductions for bad debts, although said Act thus increases the penalty, seems to violate the *ex post facto* inhibition of Article I Section 9 of the Constitution, and to conflict with the unbroken line of decisions of this Court thereon.

Respectfully submitted,

JOSEPH W. SHARTS,
Counsel for Petitioner

APPENDIX

Revenue Act of 1942; (Act of October 21, 1942; c. 619, 56 Stat. 798)

Sec. 124. Deduction for Bad Debts, Etc.

(a) *General Rule.* Section 23 (k) (relating to bad debts and securities becoming worthless) is amended as follows:

"(*k*) *Bad Debts.*

"(*1*) *General Rule.* Debts which become worthless within the taxable year; or (in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part which becomes worthless within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection.

"(2) *Securities becoming worthless.* If any securities (as defined in paragraph (3) of this subsection) became worthless within the taxable year and are capital assets, the loss resulting therefrom shall, in the case of a taxpayer other than a bank, as defined in section 104, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

"(3) *Definition of securities.* As used in paragraphs (1), (2), and (4) of this subsection the term 'securities' means bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form.

"(4) *Non-business debts.* In the case of a taxpayer, other than a corporation if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term 'non-business debt' means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

"(5) *Securities of affiliated corporations.* Bonds, debentures, notes or certificates, or other evidences of indebtedness issued with interest coupons or in registered form by any corporation affiliated with the taxpayer shall not be deemed capital assets for the purposes of paragraph (2) and paragraph (1) shall apply with respect to such debt except that no such deduction shall be allowed under such paragraph with respect to any such debt which is recoverable only in part. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

"(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

"(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents, dividends, interest or annuities or gains from sales or exchanges of stock and securities; and

"(C) the taxpayer is a domestic corporation."

(*b*) *Insurance companies.* Section 204 (c) (6) (relating to deductions allowed insurance companies other than life or mutual) is amended to read as follows:

"(6) Debts in the nature of agency balances and bills receivable which become worthless within the taxable year;"

(*c*) *Interest disallowed.* Section 3771 (relating to interest allowable on claims for refund or credit) is amended by adding at the end thereof the following:

"(*d*) *Claims based on deduction for bad debts or worthless securities.* If credit or refund of any part of an overpayment would be barred under section 322 (b), except for paragraph (5) thereof, or under section 322 (d) except for clause (2) thereof, no interest shall be allowed or paid with respect to such part of the overpayment for any period beginning after the expiration of the period of limitation provided in section 322 (b) (1) for filing claim for credit or refund of such part of the overpayment and ending at the expiration of six months after the date on which the claim was filed or, in case no claim was filed, and the overpayment was found by the Board, ending at the time the petition was filed with the Board."

(*d*) *Effective date of amendments.* The amendments made by this section adding the last sentence of section 23 (k) (1) and adding section 23 (k) (4) shall be effective only with respect to taxable years beginning after December 31, 1942; the amendment inserting section 23 (k) (5) and amendments related thereto shall be applicable only with respect to taxable years beginning after December 31, 1941; and the other amendments made by this section shall be effective with respect to taxable years beginning after December 31, 1938.

(*e*) *Cross references.* For extended period of limitation by reason of debts becoming worthless, see section 169.

Section 136 (b):

Section 145 (relating to penalties) is amended by inserting after subsection (b) the following new subsection: "(c). — Any individual who willfully makes and subscribes a return which he does not believe to be true or correct as to every material matter, shall be guilty of a felony, and upon conviction thereof, shall be subjected to the penalties prescribed for perjury in section 125 of the Criminal Code."

District of Columbia Civil Code, Title XII (31 Stat. 1389, ch. 854 Secs. 1265 and 1271):

Section 201:

"No action shall be brought * * * upon any simple contract, express or implied, after three years from the time when the right to maintain any such action shall have accrued."

Section 305:

"In actions of debt or upon the case grounded upon any simple contract, no acknowledgment or promise by words only shall be deemed sufficient evidence of a new or continuing contract whereby to take any case out of the operation of the statute * * * unless such acknowledgment or promise shall be made or contained by or in some writing to be signed by the party chargeable thereby * * *"

ROY G. FITZGERALD v. COMMISSIONER, reported at 454 CCH T. C. Dec #7540 (M).

MEMORANDUM OPINION OF TAX COURT OF THE UNITED STATES

Entered June 22, 1945, Leech, Judge (See Record, pp. 10-12).

"Respondent makes two contentions, first, that the advances by petitioner to his son-in-law and daughter were gifts and not loans in that none of them were made with the expectation of repayment, and, second, that if they were loans, the indebtedness did not become worthless to any extent in 1941 and in fact was not uncollectible in that year.

"We think the evidence clearly establishes the fact that the advances in question were made with the expectation of repayment and we have so found. However, we think it equally clear that respondent must be sustained upon his second contention. The conclusion is inescapable that the question of the possibility of collection of the indebtedness was determined without consideration of the equity owned by the son-in-law and daughter in their Washington home. It is true that it was the only property they possessed from which collection of the indebtedness could have been made. We cannot but feel, however, that petitioner was unwilling to take steps for collection because the result would have been to strip his daughter and his grandchildren of the home in which they lived.

"Considering all of the conditions revealed, we do not attach great weight to the so-called employment of a Washington attorney to enforce collection, and the opinion rendered by him. He

was a friend of all the parties and his connection with the matter was at the time when petitioner was attempting to perfect his claim for the deduction of the indebtedness on his income tax return. In any event, the facts established show that the opinion expressed by the attorney was not justified in view of the existence of an equity in the Hume home in excess of the total amount of the indebtedness owed to petitioner by the Humes plus other indebtedness of the husband.

"Section 23 (k) of the Internal Revenue Code provides for the deduction of 'Debts which become worthless within the taxable year; * * *'. This language was substituted by section 124 (a) of the Revenue Act of 1942 for the language in the former acts permitting the deduction of 'Debts ascertained to be worthless and charged off within the taxable year.' This amendment is made retroactive, by section 124 (d) of the Revenue Act of 1942, to taxable years beginning after December 31, 1938 and has been given retroactive application. *Cittadini* v. *Commissioner*, 139 Fed. 2d, 29.

"There is absolutely no showing that the condition with respect to possibility of collection changed in any way between 1938, 1939, 1940, or 1941, and aside from all other questions there is no basis for a conclusion that the indebtedness became worthless in 1941. On this ground alone petitioner would necessarily be denied the deduction. We think, moreover, that the facts clearly show that in 1941 the indebtedness was not worthless but, on the other hand, was in all probability collectible in full, if petitioner had been willing to take legal steps to enforce his collection by sale of the Hume home.

"Enter: Decision will be entered for the Respondent."

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS 6TH CIRCUIT reported 464 CCH, Court Decisions #9249. May 29, 1946. Before Hicks, Simons, and Miller, circuit judges.

Hicks, C. J.

"This cause was heard upon the transcript of record, briefs and arguments of counsel. On Consideration Whereof, the decision of the Tax Court entered June 23, 1945, is affirmed upon the grounds and for the reasons set forth in its Memorandum Findings of Fact and Opinion entered June 22, 1945 (CCH Dec. 14, 640 (M))."

JOSEPH MELTZER et al. v. COMMISSIONER, 46-4 (CCH) Court Decisions #9236; rendered April 15, 1946 by the U. S. Circuit Court of Appeals 2nd Circuit; Calendar No. 168, Doc. No. 20052. On petition to review decision of Tax Court of U. S. Affirming mem. opinion Tax Court CCH Dec. 14629 (M) reported at 454 CCH #7529 (M).

Before L. Hand, Swan, and Phillips, circuit judges. (Taxpayers had filed joint tax return for 1941 claiming deduction of $13,000 as bad debts existing from before 1935. Majority Opinion (by Phillips, J.) held the facts "fully warranted Tax Court in finding that the debt did not become worthless in 1941" and "there can be no doubt of power of Congress to make the 1942 amendment retroactive so as to apply to the taxable year 1941.")

L. Hand, C. J. (dissenting): "I agree that we must accept the finding of the Tax Court that the debt did not become worthless in 1941; but that court

did not find whether it became worthless before or after December 31, 1938. The amendment to Sec. 23 (k) (1) in 1942 was made retroactive to December 31, 1938 — Sec. 23 (k) (d) — and that, I submit, meant that the deduction of debts becoming worthless before then was to be determined under the old law. If so, debts, although they had actually become worthless before December 31, 1938, were to be deducted in the year in which the creditor 'ascertained' that they became worthless. We have ruled a number of times — last in *Mayer Tank Mfg. Co.* v. *Commissioner*, 126 Fed. 2d, 588, 591 — that the year in which a debt is 'ascertained' to be worthless is that in which the creditor in fact 'ascertained' it to be so, and not that in which he ought to have done so, or which a reasonable man would have done so. Other circuits have held the contrary — e. g. *Reading Co.* v. *Commissioner*, 132 Fed. 2d, 306, 309 (CCA 3d) — but I assume that we should follow our own precedents. The Tax Court made no finding whether the taxpayer first 'ascertained' the debt to be worthless in 1941, although I believe there was adequate basis for a finding that it was in that year. For the foregoing reasons I regard findings necessary upon the following questions: (1) Did the debt become worthless before December 31, 1938? (2) Did the taxpayer in fact 'ascertain' before 1941 that it had become worthless? I submit that this interpretation is the only one consistent with the purpose of the amendment, if as I understand to have been the case, it was intended to relieve creditors. As the law was, they were in a difficult position, because they had to prove, not only that the debt had become worthless, but that the year in which they claimed the deduction was the first in which they had 'ascertained' that it had become so; and the last in particular was often

extremely troublesome. It is true that the present law imposes upon them the risk of learning when the debt does become worthless, but in that it does no more than in the case of other losses. My brothers are now deciding that, if a creditor failed to claim deduction for a debt which actually became worthless before 1939, he may never deduct it, although he was under no duty to 'ascertain' its worthlessness in that year, the statute having assured him that he need not claim it until he in fact did 'ascertain' it. The amendment therefore increased, instead of lightened, the burden of such taxpayers, and in effect took away their privilege altogether. True, creditors whose debts became worthless in 1939, 1940, 1941, were at their peril bound to claim the deduction for those years, and it might appear that they were as much shut out as those whose debts became worthless earlier; but this is untrue, for in 1942 such creditors still had time to claim a refund for those years (Sec. 169 (a) (2) of the act of 1942). To confine the retroactivity of the amendment to debts becoming worthless after 1938 is, therefore, I submit, not only consistent with the text, but with the demands of justice.

"Finally, I think that the question is open to us upon this appeal. I should suppose that a question of law emarges with enough distinctness from any questions of fact in which it is enmeshed, to require an answer; and that question was also one of general applicability. Indeed, it would seem that our jurisdiction must extend so far, if we are to have any whatever."

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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 245

ROY G. FITZGERALD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 8–12) are not reported. The decision of the Circuit Court of Appeals (R. 33) is reported at 154 F. 2d 1017.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 10, 1946. (R. 33.) A petition for rehearing (R. 34–37) was denied May 29, 1946 (R. 38). Petition for a writ of certiorari was filed on June 29, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of

the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether petitioner was entitled to a bad debt deduction in 1941 under Section 23 (k) (1) of the Internal Revenue Code, as amended.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. [As originally enacted]
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (k) *Bad Debts.*—
>
> (1) *General Rule.*—Debts ascertained to be worthless and charged off within the taxable year * * *
>
> * * * * *
>
> (26 U. S. C. 1940 ed., Sec. 23.)

Revenue Act of 1942, c. 619, 56 Stat. 798.

> SEC. 124. DEDUCTION FOR BAD DEBTS, ETC.
>
> (a) General Rule.—Section 23 (k) (relating to bad debts and securities becoming worthless) is amended to read as follows:
>
> "(k) *Bad Debts.*—
>
> "(1) *General Rule.*—Debts which become worthless within the taxable year; * * *
>
> (26 U. S. C., Supp. V, Sec. 23.)
>
> * * * * *
>
> (d) *Effective Date of Amendments.*—The amendments made by this section add-

ing the last sentence of section 23 (k) (1) and adding section (k) (4) shall be effective only with respect to taxable years beginning after December 31, 1942; the amendment inserting section 23 (k) (5) and amendments related thereto shall be applicable only with respect to taxable years beginning after December 31, 1941; and the other amendments made by this section shall be effective with respect to taxable years beginning after December 31, 1938.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.23 (k)–1 [As amended by T. D. 5234, 1943 Cum. Bull. 119]. *Bad Debts.*—(*a*) Bad debts may be treated in either of two ways—
>
> (1) By a deduction from income in respect of debts which become worthless in whole or in part, or
>
> * * * * *
>
> (*b*) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless during the taxable year shall be allowed as a deduction in computing net income. * * * If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction for any prior taxable year shall be allowed as a deduction for the taxable year. * * * In determining whether a debt is worthless in whole or in part the

> Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. * * *
>
> Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. * * *

STATEMENT

The facts as found by the Tax Court are as follows:

Petitioner is a resident of Dayton, Ohio, and a lawyer by occupation. In computing his taxable income on his 1941 income tax return he deducted $4,452.72 as a debt which became worthless in that year. The debt consisted of money advanced to his daughter, Ruth F. Hume, and her husband, Thomas L. Hume, Jr. Its amount is based upon a statement furnished the petitioner by his son-in-law, setting out the various advances and computing a total of $4,452.72. The correct total of the items listed is $4,352.72. (R. 8.)

Thomas L. Hume, Jr., married petitioner's daughter in 1923. The couple have three children and in 1941 lived in their own home in Washing-

ton, D. C., which they had purchased in 1925. Thomas L. Hume, Jr., has been, for many years, employed as a salesman of investment securities on a commission basis and in 1941 was so employed by his father, a securities dealer in Washington, D. C. (R. 8.)

During the period 1933 to 1936, Thomas L. Hume, Jr., was in straitened financial condition due to the depression and lack of activity on the security market. During this period, at his and his wife's request, the petitioner advanced them various sums of money totaling $4,352.72. Of this total, $884.13 was evidenced by promissory notes, all of which were signed by Hume and his wife except one signed by Hume alone. The notes carried interest after maturity. The other items were advanced upon request by Hume and his wife but no note was requested or given. These advances by petitioner were for the purpose of supplying the funds with which Hume paid premiums upon his insurance policies, interest and principal on the loan on his home, as well as general living expenses and doctors' bills. Of the total, $700 was advanced for the purpose of defraying the expenses of Hume moving his family to New York to accept a position there with a security house. (R. 8–9.)

Petitioner at various times wrote his daughter and son-in-law inquiring as to their financial condition and asking for repayment, but during the years following 1936 the income of the son-in-law

was not more than the actual amount needed to pay the normal expenses of maintaining his family and no repayment was made. (R. 9.)

Thomas L. Hume, Jr., and his wife, in 1941, were occupying their home at 3114 45th Street, N. W., Washington, D. C. The title to this property stood in both of their names. It had been purchased in March, 1925, for $12,500. It is located in Wesley Heights, one of the best residential sections of Washington. Subsequent to its purchase there had been many public improvements, tending to increase the value of property at that location. After its purchase, the Humes built a garage and added a maid's room to the house. In 1941 the property was worth not less than $12,000. At that time it was encumbered with a first mortgage of $5,489.15 and a second mortgage of $550. In that year Hume was indebted for a bank loan of $500. (R. 9.)

In 1941 petitioner communicated with Hume and advised him that it was his intention to claim a deduction on his income tax return for that year in the total amount of his above-mentioned advances. In response Hume prepared a statement from his records of the various advancements, expressed regret at his inability to pay and assured petitioner that he would do anything that he could to aid him in securing the allowance of the deduction. Sometime prior to the close of the year 1941, petitioner wrote a Washington attorney who was a close friend of his and a friend of

Hume, asking him to look into the matter and collect from Hume the indebtedness or advise him as to the possibility of collection. The attorney, after talking with Hume, advised petitioner orally against filing suit and stated that in his opinion a judgment would not be collectible. This opinion he confirmed in the following year by letter. (R. 9–10.)

The amounts advanced by petitioner to his son-in-law and daughter in a total of $4,352.72 represented an indebtedness on their part to him. The advances were made with the expectation of repayment. (R. 10.)

The Tax Court accordingly found, as an ultimate fact, that the Hume debt did not become worthless in 1941. (R. 10.)

On the basis of those findings, the Tax Court held that petitioner was not entitled to a bad debt deduction for the year 1941. (R. 10–12.) The Circuit Court of Appeals affirmed upon the grounds and for the reasons set forth in the findings of fact and opinion of the Tax Court. (R. 33.)

ARGUMENT

Petitioner's principal contention is that his right to a bad debt deduction should not have been determined with reference to Section 124 (a) and (d) of the Revenue Act of 1942, *supra,* pp. 2–3, which retroactively amended Section 23 (k) (1) of the Internal Revenue Code, *supra,* p. 2, to allow deductions for "Debts which become worth-

less within the taxable year" instead of "Debts ascertained to be worthless and charged off within the taxable year," as previously provided by the Code. (Br. 10–11.) This contention is not sound. In any event, as we show *infra*, p. 9, whichever provision he applied, petitioner cannot establish that he is entitled to the deductions claimed. Thus the case fails to raise any question requiring settlement by this Court.

Since the 1942 amendment was made retroactive "with respect to taxable years beginning after December 31, 1938," there plainly is no merit to petitioner's position that the amendment does not cover his claim for a deduction in 1941. See *Cittadini* v. *Commissioner*, 139 F. 2d 29 (C. C. A. 4); *Meltzer* v. *Commissioner*, 154 F. 2d 776 (C. C. A. 2) pending upon petition for a writ of certiorari, No. 239, this Term. Certainly the dissenting opinion of Judge Learned Hand in *Meltzer* v. *Commissioner, supra*, on which petitioner relies (Br. 10), furnishes no support for a contrary conclusion. Judge Hand interpreted the quoted language as meaning that deductions for debts which became worthless prior to December 31, 1938, are to be determined under the former law. This interpretation is not the same as petitioner's assumption (Br. 10) that the date the Hume debt originally arose is controlling. Moreover, regardless of its merits, Judge Hand's interpretation does not apply here. Petitioner's own testimony before the

Tax Court (R. 27–28) indisputably shows that the Hume debt did not become worthless prior to December 31, 1938, or even prior to 1941 and the Tax Court held that the debt had not become worthless by or in 1941 (R. 11–12).

Petitioner's contention that the application of the amended statute deprives him of due process is based on his assumption that the statute deprives him "of all right of deduction." (Br. 10.) He has in fact been deprived of nothing and is not in a position to complain of the retroactivity of the 1942 amendment on constitutional grounds. As already stated, his testimony before the Tax Court showed that the Hume debt did not become worthless prior to 1941. He therefore never was entitled to a deduction for the debt in any prior year, since a showing of worthlessness has been prerequisite to a deduction under Section 23 (k) (1) both before and after the 1942 amendment. *Spring City Co.* v. *Commissioner,* 292 U. S. 182, 185–189; *Mayer Tank Mfg. Co.* v. *Commissioner,* 126 F. 2d 588 (C. C. A. 2); *Rockefeller* v. *Nunan,* 142 F. 2d 354 (C. C. A. 2), certiorari denied, 323 U. S. 732; *Herder* v. *Helvering,* 106 F. 2d 153, 157 (App. D. C.), certiorari denied, 308 U. S. 617; *Allen-Bradley Co.* v. *Commissioner,* 112 F. 2d 333 (C. C. A. 7); *H. D. Lee Mercantile Co.* v. *Commissioner,* 79 F. 2d 391 (C. C. A. 10). And so far as 1941 is concerned, he is not required to prove as much under the amended statute as he

would have had to prove under the former statute.[1] Moreover, the retroactivity of the 1942 amendment has been judicially approved on the ground that deductions are matters of legislative grace. *Cittadini* v. *Commissioner, supra; Meltzer* v. *Commissioner, supra.*

Contrary to the petitioner's position (Br. 11), the amended statute is not *ex post facto.* To be such it must have operated retroactively to impose a penalty, fine or imprisonment on petitioner. *Calder* v. *Bull,* 3 Dall. 386; *Thompson* v. *Utah,* 170 U. S. 343. While petitioner may be correct in stating that the 1942 amendments to the Internal Revenue Code added a new penalty to the Code (Br. 11), the retroactivity of the amendment to Section 23 (k) (1) obviously did not have the effect of making petitioner subject to that penalty.[2]

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[1] Section 23 (k) (1) was amended because "considerable difficulty" was caused by the additional requirements of the former statute that the taxpayer prove that he had "ascertained" the debt to be worthless and had charged it off during the taxable year. H. Rep. No. 2333, 77th Cong., 2d Sess., p. 44, par. 3 (A). This difficulty appears to have stemmed from conflicting views as to whether an objective or subjective test should be applied in determining whether the deduction had been claimed in the proper year. See, e. g., *Rosenthal* v. *Helvering,* 124 F. 2d 474 (C. C. A. 2); *Mayer Tank Mfg. Co.* v. *Commissioner, supra; Reading Co.* v. *Commissioner,* 132 F. 2d 306 (C. C. A. 3), certiorari denied, 318 U. S. 778.

[2] The statute petitioner relies upon provides only that one who "willfully" makes and subscribes a return "which he

Finally, there is no conflict between the decision below, which adopts the opinion of the Tax Court, and Section 19.23 (k)–1 of Treasury Regulations 103, *supra*, pp. 3–4. Petitioner's assertion of conflict (Br. 9) seems to be premised solely upon the assumption that the District of Columbia statute of limitations barred legal action on the Hume debt. Aside from the fact that this assumption is without question erroneous,[3] the plain language of the Regulations makes it clear that a deduction is not allowable simply because a debtor may have a legal defense to a suit to enforce payment; a showing of worthlessness and uncollectibility is also required. And see *H. D. Lee Mercantile Co.* v. *Commissioner*, 79 F. 2d 391 (C. C. A. 10).[4] The question of worthlessness is one of fact on which the decision of the Tax

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does not believe to be true or correct as to every material matter" shall be guilty of a felony and subjected to the penalties prescribed for perjury. (Br. 11.)

[3] Under the District of Columbia Code (1940), Section 12–305, a written acknowledgment of the debt or promise to pay tolls the running of the statute. Among the photostat exhibits filed in this case are copies of several letters in which Hume acknowledged his debt to petitioner in 1941. Accordingly, it would appear that the Tax Court was correct in stating that in 1941 the Humes' debt not only was not worthless but "in all probability collectible in full, if petitioner had been willing to take legal steps to enforce his collection by sale of the Hume home." (R. 11–12.)

[4] *Duffin* v. *Lucas*, 55 F. 2d 786, 795 (C. C. A. 6), certiorari denied, 287 U. S. 611, relied upon by petitioner (Br. 9), does not hold to the contrary. In that case, which involved an

Court is conclusive unless without rational basis in the evidence. *Boehm* v. *Commissioner,* 326 U. S. 287. If, however, petitioner's argument on this point should be interpreted as a contention that the Tax Court's conclusion that the Hume debt did not become worthless in 1941 has no support in the record, it is sufficient to point out that petitioner himself testified before the Tax Court that he made the loan to the Humes because Mr. Hume was an able-bodied man with earning capacity, that Hume "should and ought, in due course, to repay every bit of it," and "I still think that there is a chance of the loan being collected some day." (R. 29.)

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application of the former statute, the taxpayer claimed a bad debt deduction in 1920, which was two years after the expiration of the period of limitations. The question was whether the taxpayer had claimed the deduction in the wrong year. The court held that he had, but only because he had failed to show that the statute of limitations had not run because of absence, minority, a new promise to pay, etc., or that in 1918 he had substantial reason to think he might nevertheless eventually get part payment.

CONCLUSION

The decision below is correct and involves no conflict of decisions or important question of law. The petition for a writ of certiorari should therefore be denied.

Resectfully submitted,

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